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EAST ASIA BRIEF C [REDACTED] FOR 24 OCTOBER

FROM: DDI/O/CPAS.

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Date OCT 1998

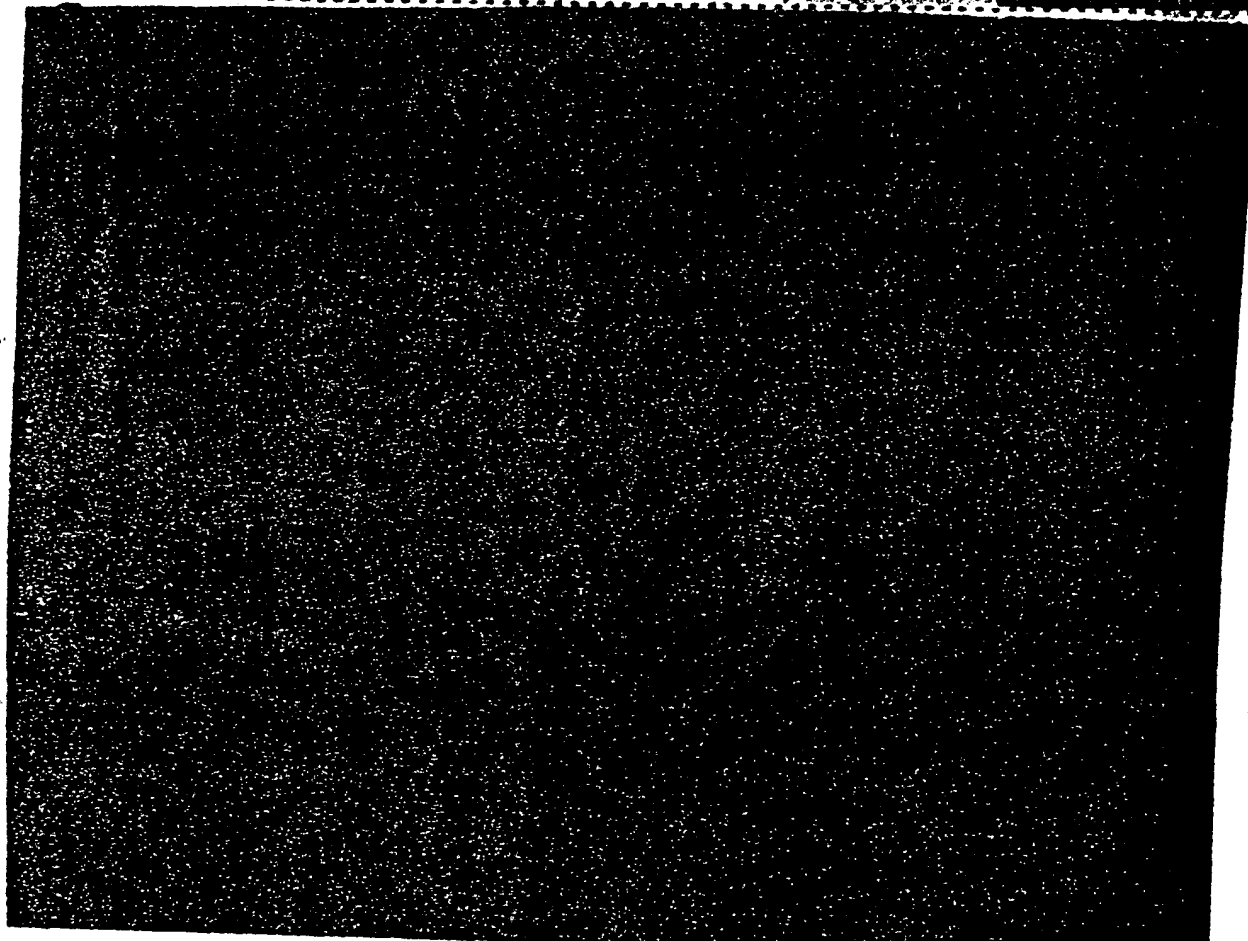
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2. HONG KONG - CHINA - UK: IMPROVED ATMOSPHERE FOR TALKS

//SERIOUS ECONOMIC PROBLEMS IN HONG KONG HAVE LED CHINA AND THE UK TO SHOW GREATER FLEXIBILITY IN THEIR TALKS ON THE COLONY'S FUTURE.//

//THE COUNTRIES ENDED TWO DAYS OF TALKS IN BEIJING ON THURSDAY BY ISSUING A JOINT STATEMENT DESCRIBING THE DISCUSSIONS AS "USEFUL AND CONSTRUCTIVE." THEY HAVE AGREED TO MEET AGAIN NEXT MONTH.//

//PRESS REPORTS INDICATE THAT PRIME MINISTER THATCHER, IN A RECENT LETTER TO PREMIER ZHAO, DROPPED LONDON'S INSISTENCE ON A FORMAL BRITISH PRESENCE AFTER CHINA REGAINS SOVEREIGNTY AND INSTEAD ASKED ONLY FOR A SUBSTANTIAL BRITISH ROLE. THE CHINESE HAVE

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SUBSEQUENTLY TONED DOWN THEIR MEDIA ATTACKS ON THE UK'S POSITION.//

//LAST WEEK THE HONG KONG GOVERNMENT STABILIZED THE LOCAL CURRENCY BY ABANDONING THE FREE-FLOATING EXCHANGE RATE IN FAVOR OF A FIXED RATE OF 7.8 HONG KONG DOLLARS PER US DOLLAR. THE COLONY'S TWO NOTE-ISSUING BANKS NOW ARE REQUIRED TO BACK HONG KONG DOLLARS THEY ISSUE BY DEPOSITING AN EQUIVALENT AMOUNT OF US DOLLARS WITH THE GOVERNMENT. THE BRITISH AUTHORITIES ALSO LIFTED THE 10-PERCENT WITHHOLDING TAX ON INTEREST EARNED ON HONG KONG DOLLAR DEPOSITS TO ENCOURAGE INCREASED HOLDINGS OF LOCAL CURRENCY.//

//BOTH SIDES ARE ANXIOUS TO PREVENT A RECURRENCE OF THE NEAR PANIC IN HONG KONG THAT FOLLOWED THE TALKS LAST MONTH WHEN THE LOCAL CURRENCY'S VALUE FELL AMOST 15 PERCENT OVERNIGHT.

//THE IMPROVED ATMOSPHERE MAY BE SHORT LIVED. THE MONETARY CONTROLS ARE UNLIKELY TO DO MORE THAN STABILIZE TEMPORARILY THE VALUE OF THE LOCAL CURRENCY SO LONG AS THE COLONY'S UNCERTAIN FUTURE CONTINUES TO CAUSE CAPITAL FLIGHT.//

//MOREOVER, THE TWO SIDES REMAIN FAR APART AND HAVE NOT YET BEGUN TO DISCUSS THE COMPLEX DETAILS OF TURNING HONG KONG OVER TO CHINESE CONTROL WHEN THE UK'S LEASE EXPIRES IN 1997. THE CHINESE ARE STILL PRESSING FOR AN EARLY BRITISH CONCESSION ON SOVEREIGNTY.

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